



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Number: **200809044**
Release Date: 2/29/2008

Date: December 6, 2007

237729

Contact Person:

Identification Number:

Telephone Number:

Employer Identification Number:

Uniform Issue List:

507.00-00

4941.00-00

4945.00-00

Legend:

A =

B =

M =

N =

P =

Q =

S =

R =

T =

U =

Dear :

This is in response to your request for a ruling that the early termination of M will not constitute a termination of M's private foundation status under section 507 of the Internal Revenue Code and will not result in the imposition of tax under section 4941(d) and 4945 of the Code.

M is an inter vivos charitable remainder unitrust described in section 664(d)(2) of the Code and a split interest trust under section 4947(a)(2). M was created on May 11, , by N

and the Trustee. M was amended on March 6, . The Grantor is a family limited partnership referred to as "N". N is also the income beneficiary. A and B (hereinafter referred to as the "Grantors") are the sole partners of N. M is located in P. A is the trustee of M.

Under the Trust Agreement, N receives a unitrust amount equal to the lesser of (a) the Trust's income, or (b) eleven percent (11%) of the net fair market value of M's assets valued as of the first day of each taxable year of the M, payable in equal quarterly installments at the end of each calendar quarter. The Trust Agreement does not have a "net income make-up" provision.

M will terminate 20 years after its creation or upon the earlier death of the survivor of A or B, at which time M will terminate and the assets remaining in the Trust will be distributed to the then designated charitable remainder beneficiaries, S, T, and U. All three beneficiaries are exempt from federal income taxation under section 501(c)(3) of the Code, and are further classified as publicly supported organizations.

N, the Grantors, and S have determined that the charitable purposes of the Trust and S, T, and U, would be better served by an early termination of the Trust and distribution of the remainder interest directly to the beneficiaries. N proposes terminating the Trust by selling its income interest in the Trust to the charitable remainder beneficiaries for an amount equal to the present value of its life income interest in the Trust. Since this will result in a significantly higher amount passing to charity upon the termination of the Trust than originally anticipated, the Grantor intends to exercise the power under the Trust Agreement to add, remove or replace remainder beneficiaries by adding a community foundation and an arts center that are both qualified as organizations described in section 509(a)(1) and 170(b)(1)(A)(vi) as additional remainder beneficiaries under the Trust. Any reference to all three charitable remainder beneficiaries includes S and the added arts center and community foundation.

In your ruling request, you stated that the actuarial values of the respective interests will be calculated using the discount rate in effect at the date of sale under section 7520 of the Code, and the methodology for valuing interests in charitable remainder trusts contained in section 1.664-4 of the Income Tax Regulations (the regulations).

The Trustee will file a petition in Probate Court in Q seeking court approval for the early termination of the Trust, and in connection with the court action, the consent of the R Attorney General will be obtained prior to termination. R law permits early termination of the Trust and the R Attorney General's office has informally indicated that it has no objections to the Trust's termination.

A and B's birthdates are January 13, and July 20, , respectively. A and B are aware of no physical condition that would decrease either's normal life expectancy. In the June 21, 2006, ruling request, it is represented that a physician will provide a signed affidavit that, based on recently performed physical examinations of A and B, to the best of the physician's knowledge, neither A nor B's life expectancy is less than would otherwise be expected for their respective ages.

After discussions with our office, you submitted a letter dated April 3, 2007, in which the Grantors agreed to accept the Internal Revenue Service proposed valuation methodology for valuing the remainder interest in the trust.

RULINGS REQUESTED

You have requested the following rulings:

- (1) Early termination of M and the distribution of the Trust's property to N, the income beneficiary and the charitable remainder beneficiaries will not constitute an act of self-dealing under section 4941(d) of the Code.
- (2) Early termination of M and the distribution of the Trust's property to N and the charitable remainder beneficiaries in proportion to the present value of their respective interests will not constitute a taxable expenditure under section 4945 of the Code.
- (3) The proposed termination of M and distribution of the Trust's property will not be subject to a termination tax under section 507 of the Code.

LAW

Section 507(c) of the Code imposes a tax on a private foundation under certain circumstances.

Section 4941(a)(1) of the Code imposes an excise tax on disqualified persons for each act of self-dealing between a disqualified person and a private foundation.

Section 4941(d)(1) of the Code defines self-dealing as including any direct or indirect:

- (A) sale or exchange, or leasing of property between a private foundation and a disqualified person, or
- (E) transfer to, or use by or for the benefit of, a disqualified person of the income or assets of a private foundation.

Section 4945(a)(1) of the Code imposes a tax on each taxable expenditure of a private foundation, payable by the private foundation.

Section 4945(d) of the Code defines "taxable expenditure" as including a grant to an organization unless the organization is described in paragraph (1), (2), or (3) of section 509(a) or is an exempt operating foundation or unless the private foundation exercises expenditure responsibility with respect to the grant, and a grant for any purpose other than one specified in section 170(c)(2)(B).

Section 4946(a)(1) of the Code provides that for purposes of this subchapter, the term "disqualified person" means, with respect to a private foundation, a person who is—

- (A) a substantial contributor to the foundation,
- (B) a foundation manager (within the meaning of section (b)(1).

Section 4946(a)(2) of the Code provides that for purposes of paragraph (1), the term "substantial contributor" means a person who is described in section 507(d)(2).

Section 4946(b) of the Code provides that for purposes of this subchapter, the term "foundation manager" means, with respect to any private foundation:

- (1) an officer, director, or trustee of a foundation (or an individual having powers or responsibilities similar to those of officers, directors, or trustees of the foundation, and
- (2) with respect to any act (or failure to act), the employees of the foundation having authority or responsibility with respect to such act (or failure to act).

Section 4947(a)(2) of the Code provides, in pertinent part, that in the case of a trust which is not exempt from tax under section 501(a), not all of the unexpired interests of which are devoted to charitable purposes, and which has amounts in trust for which a charitable deduction was allowed, sections 507 and 4941 apply as if such trust were a private foundation.

Section 4947(a)(2)(A) of the Code provides that section 4947(a)(2) shall not apply with respect to any amounts payable under the terms of such trust to non-charitable income beneficiaries..

Section 53.4947-1(c)(2)(ii) of the Foundation and Similar Excise Taxes Regulations provides, in essence, that payments of income by a charitable remainder unitrust to its individual income beneficiaries do not result in any tax on self-dealing under section 4947.

Section 1.7520-3(b)(1)(ii) of the regulations provides that the standard 7520 annuity, life estate, or remainder factor may not be used to value a restricted beneficial interest. However, a special factor may be used to value a restricted beneficial interest in some circumstances. Section 1.7520-3(b)(1)(i)(C) provides that the standard factor for an ordinary remainder interest represents the present worth of the right to receive \$1.00 at the end of a defined period. Section 1-7520-3(b)(1)(i)(B) provides that the standard factor for an ordinary life estate interest represents the right to receive the use of \$1.00 for a defined period.

ANALYSIS

M is a split-interest trust described in sections 4947(a)(2). By being described in section 4947(a)(2), M is subject to the provisions of sections 507, 4941, and 4945, as if it were a private foundation. The income beneficiary, N, is a disqualified person with respect to M within the meaning of section 4946(a)(1)(A) as a substantial contributor to M. A and B, are disqualified

persons with respect to M within the meaning of section 4946(a)(1)(F) by virtue of their ownership of N, the settlor.

In this case, the charitable remainder beneficiaries are public publicly supported organizations so for purposes of section 4941 and 4946, the income beneficiary is not a disqualified person with respect to the charitable remainder beneficiaries.

Section 4941 applies to certain transactions between private foundations and disqualified persons. By early termination, M will distribute lump sums to the income beneficiary, N, and the charitable remaindermen, S, T, and U, equal to actuarial value of their interests in M (taking into account the net-income provisions of the trust). The distributions are also treated as a constructive sale or exchange between A, B and S, T, and U. See Rev. Rul. 69-486.

Generally payments to the income beneficiary, N, and indirectly A and B, would constitute self-dealing. However, because the distribution to the income beneficiary equals the actuarial value of the income interest, taking into account the net-income provisions of the trust, the exception to self-dealing provided by section 53.4947-1(c)(2)(i) of the regulations applies and the distribution will not be an act of self-dealing. Furthermore, because S, T, and U are all publicly supported organizations, section 4941 does not apply to the transaction between N (or A and B) on one part, and such charitable beneficiaries on the other.

The appropriate calculation of the actuarial value of the income interest of M, taking into account the net-income provisions of the trust, requires the use of a reasonable method for the calculation which does not inappropriately inflate the income beneficiaries' interest to the detriment of the charitable remaindermen.

One reasonable method to calculate the actuarial value of the income and remainder interests is the following:

The computation of the remainder interest is found using a special factor as indicated in section 1.7520-3(b)(1)(ii) of the regulations. The special remainder factor is found by using the methodology stated in section 1.664-4 for computing the factor for a remainder interest in a unitrust, with the following modification: where section 1.664-4(a)(3) of the regulations provides an assumption that the trust's stated payout percentage is to be paid out each year, instead the assumed payout shall be that of a fixed percentage which is equal to the lesser of the trust's stated payout percentage or the section 7520 rate for the month of termination. The special factor for the non-charitable payout interest is 1 minus the special remainder factor.

Based on this methodology, the calculation of A and B's income interest in M may be demonstrated as follows:

The section 7520 rate for December 2006 is 5.8 percent. Assuming the termination occurred in December 2006, the lesser of this rate and the trust's stated payout percentage is 5.8 percent. The assumed taxpayers' ages as of their nearest birthdays are 77 and 79, respectively. Based on Table 90CM, interest at 5.8 percent, an unadjusted

payout rate of 5.8 percent, and quarterly payments made at the end of each quarter, the present value of the remainder interest in a unitrust which falls in 12 years and 5 months hence or at the prior death of the last to die of two persons aged 77 and 78 is \$0.55483 for each \$1.00 of the trust estate. The present value of the payout interest in the same unitrust until such time is \$1.00 minus \$0.55483 or \$0.44517 for each \$1.00 of the trust estate.

In this case, the income beneficiary is not expected to receive more than it would during the full term of the trust under the above-described methodology for valuing its interest in a charitable remainder trust. Further, state law provides for early termination under the facts presented.

In addition, A and B's personal physician has conducted a physical examination and has stated under penalties of perjury that he finds no medical condition expected to result in a shorter-than-average longevity (under section 1.72-9 of the Regulations); and A and B have signed a similar statement.

Furthermore, because the effect of the transaction is to vest the income interest and remainder interest in the remainder beneficiaries, the trust no longer will be a split-interest trust and section 4947(a)(2) will no longer apply and section 507 will not apply.

CONCLUSIONS

Therefore, we rule that:

- (1) Early termination of M will not constitute an act of self-dealing under section 4941(a)(1) of the Code by A as trustee or by N (or A and B) as donors with respect to M using the methodology described on the prior page for the effective date of termination as approved by the Probate Court in Q.
- (2) Early termination of M and subsequent distributions of the Trust's property will not constitute a taxable expenditure under section 4945 of the Code using the methodology described on the prior page for the effective date of termination.
- (3) The proposed termination of M and distribution of the Trust's property will not be subject to a termination tax under section 507 of the Code.

This ruling will be made available for public inspection under section 6110 of the Code after certain deletions of identifying information are made. For details, see enclosed Notice 437, *Notice of Intention to Disclose*. A copy of this ruling with deletions that we intend to make available for public inspection is attached to Notice 437. If you disagree with our proposed deletions, you should follow the instructions in Notice 437.

This ruling is based on the facts as they were presented and on the understanding that there will be no material changes in these facts.

We express no opinion as to the tax consequences of the transactions under other provisions of the Code.

Pursuant to Power of Attorney on file in this office, a copy of this letter is being sent to M's authorized representative. A copy of this letter should be kept in M's permanent records.

This ruling is directed only to the organization that requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited by others as precedent.

If you have any questions about this ruling, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

/s/

Robert C. Harper, Jr.
Manager, Exempt Organizations
Technical Group 3

Enclosure
Notice 437